89-594

No.

Supreme Court, U.S.
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In The Supreme Court of the United States
October Term, 1989

CLIFT C. LANE and DOROTHY P. LANE,

Petitioners,

v.

JOHN E. PETERSON, JR., WALTER W. MINGER, and EDWARD H. COVELL,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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QUESTIONS PRESENTED

1. In a diversity case, does the District Court's failure to apply state law regarding the burden of proof and presumption of fraud, as they pertain to self-dealing by a fiduciary, divest the District Court of subject matter jurisdiction rendering its judgement void within the meaning of Rule 60 (b) (4) of the Federal Rules of Civil Procedure?

2. Does the District Court's failure to apply Arkansas law constitute extraordinary circumstances entitling Petitioners to relief from the District Court's judgment pursuant to Rule 60 (b)(6)?

LIST OF PARTIES

Respondents are included in this Petition, as they were in the courts below, both as individuals and in their capacity as members of a Special Panel created under a Consolidated Plan of Reorganization confirmed by the United States Bankruptcy Court for the Middle District of North Carloina, Greensboro Division; and as trustees and beneficiaries U/D/C dated July 22. 1985.

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JOHN E. PETERSON, JR., WALTER W. MINGER, and EDWARD H. COVELL,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Petitioners, Clift C. Lane and Dorothy P. Lane, respectfully pray that a writ of certiorari issue to review the judgement and opinion of the United States Court of Appeals for the Eighth Circuit, entered in the above-entitiled proceeding on July 17, 1989.

OPINIONS BELOW

The *per curiam* opinion of the Court of Appeals will not be reported; the opinion is reprinted in the Appendix at p. 1a.

The Order and Supplemental Order of the District Court for the Western District of Arkansas, Texarkana Division, No. 86-4069 (Harris, J.) were not reported; the Order and Supplemental Order are reprinted in the Appendix at 4a and 7a, respectively.

JURISDICTION

Petitioners moved pursuant to Rule 60(b)(4) and (6) to vacate a final judgment entered by the District Court and affirmed by the Court of Appeals. Jurisdiction in the District Court was based upon 28 U.S.C. §1332, diversity of citizenship. On January 18, 1989, the District Court denied Petitioners' motion. On March 6, 1989, the District Court imposed sanctions upon Petitioners and their counsel for filing the motion to vacate.

On Petitioners' appeal, the Eighth Circuit affirmed the District Court's Order and Supplemental Order on July 17, 1989.

STATUTE INVOLVED

Judiciary Act of 1789, Section 54
28 U.S.C. §1652 (1982). *State laws as rules of decision.*

The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States in cases where they apply.

Rule 60(b):

On motion and upon such terms as are just, the court may relieve a party or a party's legal representative from a final judgment, order, or proceeding for the following reasons: . . . (4) the judgment is void; . . . (6) any other reason justifying relief from the operation of the judgment. The motion shall be made within a reasonable time, . . .

STATEMENT OF THE CASE

Petitioners (the "Lanes") founded and developed their chicken business over more than thirty-five years from a small, one-truck operation to the nation's sixth largest poultry producer. They owned the entire business either directly or indirectly through their ownership of the stock of nineteen operating companies (the "Lane companies").

In 1982, the Lanes, personally, and each of the Lane Companies, petitioned for reorganization under the Bankruptcy Code of 1978. Shortly thereafter, the Bankruptcy Court appointed Respondent Peterson its Examiner; Peterson served as Examiner at least through March, 1987. The Bankruptcy Court confirmed a consolidated plan of reorganization (the "Plan") in 1984. Section 7.05 of the Plan created a Special Panel "to aid in the operation of the business of Lane in the post-confirmation era both for the benefit of Lane and Creditors" (Plan, Disclosure Statement, p. 20, 1984). The Lanes, with the approval of the Bankruptcy Court and the Creditors, selected Peterson, the Bankruptcy Court Examiner, and Respondents Minger and Covell to serve on the Special Panel.

Under the Plan, the Special Panel was obligated to temporarily assume management of the Lane Companies if an Event of Default was not timely cured. The Creditors noticed several Events of Default in May and June of 1985. Unless cured, the Special Panel would have assumed management of the Lane Companies about August 1, 1985. By mid-June, it appeared unlikely that the defaults would be cured.

To preserve their equity in the business, the Lanes decided to sell the Lane Companies and repay Creditors. The Lanes advised the Creditors and the Special Panel on June 19, 1985 of their decision to sell the Lane Companies. On June 24, 1985, Minger received an offer from Tyson Foods, Inc. to purchase the Lane companies after the Special Panel assumed control. The members of the Special Panel discussed the offer among themselves, but did not disclose the offer to the Lanes. The Lanes first learned of Tyson's offer after the Respondents sold the Lane Companies to Tyson for thirty-five million dollars in April, 1986.

In order to concentrate their efforts on the sale of the Lane Companies, the Lanes agreed to permit the Special Panel to assume management of the Lane Companies on July 22, 1985, approximately ten days before the Special Panel was obligated to do so under the Plan. The Special Panel demanded, as a condition of assuming control early, that the Lanes transfer their stock in the Lane Companies to a trust (the "Trust") with the Special Panel members as trustees. The Lanes believed that they were the beneficiaries of the Trust. The Special Panel refused to give the Lanes a copy of the trust declaration and did not disclose to the Lanes that the members of the Special Panel were the settlors and, through the exercise of Respondents' unfettered discretion, the sole beneficiaries as well as trustees of the Trust. Accordingly, in good faith reliance upon their counsel and the Special Panel, the Lanes consented to transfer the Stock to the Trust. The transaction was consummated on July 22, 1985. At the closing, the Lanes endorsed stock certificates to the Special Panel as trustees under the Trust. There was no

document ever presented to or executed by the Lanes conveying any beneficial interest in their stock of the Lane Companies.

The Lanes first learned of the Special Panel's beneficial interest in the stock of the Lane Companies when they commenced an action against Respondents in May, 1986. After a trial on the merits, the District Court entered judgment for the Special Panel holding that the Lanes "have failed to sustain their burden of proof on each count of their complaint" *Lane v. Peterson,* No. 86-4069, p. 27 (W.D. Ark. July 2, 1987). The decision was appealed to the Eighth Circuit Court of Appeals which affirmed the District Court, *Lane v. Peterson,* 851 F. 2d 193 (8th Cir. 1988). Plaintiffs did not petition the Supreme Court for a writ of certiorari.

In December, 1988, the Lanes, through newly retained counsel, moved pursuant to Rule 60(b), to vacate the judgment entered by the District Court on July 2, 1987 because the court failed to ascertain and apply state law regarding self-dealing by a fiduciary as required in deciding diversity cases. Without addressing the Lanes' substantive basis for relief, the District Court denied the motion as being untimely. Shortly thereafter, the court granted Respondents' motion to impose sanctions upon the Lanes and their new counsel under Rule 11. In a *per cruiam* opinion filed July 17, 1989, the Court of Appeals, also without addressing the substantive basis for relief, affirmed the District Court's decision.

REASONS FOR GRANTING WRIT

I. Under *Erie*, federal courts have subject matter jurisdiction to decide diversity cases only in accordance with state substantive law; failure to apply state law conflicts with the Judiciary Act of 1789 and decisions of this Court.

In contrast to transactions conducted at arm's length between strangers, Arkansas law imposes an affirmative obligation upon anyone in whom trust and confidence is justifiably reposed to act with candor and the utmost good faith in dealing with his *cestui que trust.* The policy is set forth in *Taylor v. Gordon,* 169 Ark. 1132, 278 S.W. 26 (1925):

> "The principle, we think is well settled that a trustee or one who occupies a relation of confidence in the management or the sale of property cannot deal with it in any manner for his own benefit . . ." (at 1142)
>
> "Where an agent who is intrusted with the sale of property purchases it himself without disclosing the fact that he is the purchaser to the owner, the sale will be cancelled in a court of equity at the instance of the owner . . ." (at 1142)
>
> "The burden is on the trustee or agent occupying the confidential relation to show that the transaction was in the utmost good faith; otherwise a court of equity will set it aside" (at 1142-43)

The fiduciary, not the *cestui,* has the burden of proof; the fiduciary's failure to disclose his personal interest in a transfer of the *cestui's* property creates an irrebutable presumption of fraud. Both are substantive state rights which federal courts are obligated to apply in diversity cases. *Cities Service Oil Co. v. Dunlap,* 308 U.S. 208 (1939) (burden of proof); *Dick v. New York Life Ins. Co.,* 359 U.S. 437 (1959) (presumptions).

If Respondents are fiduciaries with respect to the Lanes, a matter assumed, but not decided, by the District Court, *see Lane v. Peterson,* 851 F. 2d 193, 196 (8th Cir. 1988), they, not the Lanes, had the burden of proving full disclosure and good faith dealing. Under the holding in *Taylor v. Gordon,* Respondents' failure to disclose their beneficial interest in the Trust rendered the transfer of stock of the Lane Companies voidable at the request of the Lanes. Neither the District Court nor the Court of Appeals conidered Arkansas law regarding self-dealing by fiduciaries. Neither court cited contrary Arkansas authority nor did either court cite Arkansas authority for its holding that Respondents breached no fiduciary duty to the Lanes.

Limits on the authority of federal courts to decide diversity cases was the heart of *Erie R.R. Co. v. Tomkins,* 304 U.S. 64 (1938). This Court held in *Erie* that Section 54 of the Judiciary Act of 1789 constitutionally mandated federal courts to apply state judicial law as well as state statutory law as their rule of decision in diversity cases. Federal courts have no discretion under Section 54 to apply any other rule of decision except applicable state law. In the instant case, neither court ascertained or applied Arkansas law pertaining to self-dealing by fiduciaries; they applied their own rule of decision creating the kind of conflict between federal and state courts *Erie* sought to eliminate.

It is important for the efficient operation of the federal judiciary for this Court to determine whether a federal court exceeds its authority under Section 54 if it fails, for any reason, to ascertain and apply state substantive law in diversity cases. To insure there is not subtle erosion of the force of *Erie,* the federal courts should be required to ascertain and apply state law as a jurisdictional

requirement in diversity cases. Only a clear holding by this Court will insure uniform compliance with the mandates of *Erie.* Such a requirement imposes no unwarranted burden on the federal judiciary: in fact, the rule will promote judicial economy by forcing courts to consider the question and will prevent the issue being overlooked or avoided. This Court should decide, uniformly and finally, that federal courts exceed their jurisdiction to decide diversity cases if they fail to apply state substantive law.

II. The District Court's failure to apply Arkansas substantive law regarding self-dealing by a fiduciary constitutes extraordinary circumstances justifying relief from judgment pursuant to Rule 60(b)(6) and raises important, unresolved questions of policy regarding final judgments.

By not applying the law of Arkansas regarding self-dealing by a fiduciary as required under *Erie,* the District Court has deprived the Lanes of substantive rights created by the state of Arkansas. If the policy set forth in *Taylor v. Gordon* had been applied, the Lanes could void the transfer of their stock to Respondents. Depriving the Lanes of this fundamental right, a denial of equal protection and due process under *Erie,* works a manifest injustice. Moreover, allowing the judgment to stand, permits a fiduciary to profit from his dealings with his *cestui* without full disclosure of the fiduciary's interest and without insistance upon scrupulous fairness on the part of the fiduciary. Such a result is bad public policy which encourages faithlessness to trusts and does not accord with either Arkansas law or federal law. *See, Michoud v. Girod,* 4 How. 503 (1846); *see also Meinhard v. Salmon,* 249 N.Y. 458, 164 N.E. 545 (1928) (opinion by Cardozo, Chief Judge).

The policy favoring the finality of judgments is in direct conflict with the policies underlying *Erie.* This Court has held that federal courts have the power under Rule 60(b)(6) "adequate to enable them to vacate judgments whenever such action is appropriate to accomplish justice," *Klapprott v. United States,* 335 U.S. 601, 603 (1950); *See also, Liljeberg v. Health Services Acquisition Corp.,* 108 S. Ct. 2194 (1988) ("justice must satisfy the appearance of justice"). The policy favoring finality should not be used to promote injustice. Respondents held positions of trust. As court appointed officers they should not be shielded from the consequences of a breach of that trust. Respondents have not relied upon the District Court's judgment to their detriment, *see, Liljeberg, supra.* There is no prejudice to Respondents if the judgment is vacated and their conduct measured against the standard established in *Taylor v. Gordon, supra.* Respondents are not entitled to retain a windfall because the District Court neglected to apply the appropriate state standard. This Court should make clear that the requirements of *Erie* take precedence over the policy favoring the finality of judgments.

CONCLUSION

For the reasons set forth herein, this petition for certiorari should be granted. The Court of Appeals decision should be reversed and the case be remanded to determine the issues in accordance with Arkansas law regarding self-dealing by fiduciaries.

Respectfully submited,

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APPENDIX A—OPINION OF COURT OF APPEALS

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

Clift C. Lane, et al.,

Appellants

v.

John E. Peterson, Jr., et al.,

Appellees.

Nos. 89-1329
89-1508

Submitted: June 28, 1989
Filed: July 17, 1989

Before ARNOLD, BOWMAN, and MAGILL, Circuit Judges.

PER CURIAM.

Clift and Dorothy Lane appeal from the District Court's[1] order denying their Rule 60(b) motion to vacate judgment, and sanctioning the Lanes and their attorney, Raymond T. Mundy, under Federal Rule of Civil Procedure 11.[2] We affirm.

The Lanes owned a poultry business which became the subject of a Chapter 11 reorganization proceeding. When the plan did not generate the expected funds, the Lanes agreed to transfer their stock to a panel established as part of the reorganization plan. Less than one year

later, the panel sold the stock for $35 million, and the Lanes filed a diversity action against the panel seeking to recover the stock or its proceeds. After a five-day bench trial, the Court denied relief. On appeal the Lanes argued that the District Court erred in failing to impose a constructive trust on the sale proceeds, but did not attack the Court's interpretation of Arkansas law. The panel appealed the Court's denial of their request for sanctions under Federal Rule of Civil Procedure 11. On June 30, 1988, we affirmed the decision and the denial of sanctions. *Lane v. Peterson,* 851 F.2d 193 (8th Cir. 1988). The Court denied rehearing on August 2, 1988.

On December 21, 1988, Mundy, a New York attorney who had not represented the Lanes previously, filed a motion to vacate judgment. He argued that the District Court committed legal error in failing to apply Arkansas trust law, and that such error rendered the judgment void under Rule 60(b)(4) or, alternatively, gave rise to exceptional circumstances justifying relief under Rule 60(b)(6). The Court denied the motion and assessed sanctions against the Lanes and Mundy. This appeal followed.

The District Court's opinion and this Court's affirmance were based on the application of Arkansas law. The Lanes' Rule 60(b) motion is merely a belated effort to

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1. The Hon. Oren Harris, Senior United States District Judge for the Eastern and Western Districts of Arkansas.

2. This Court lacks jurisdiction to decide whether sanctions were properly assessed against Mundy because he is not listed as a party on the notice of appeal. See *Rogers v. National Union Fire Ins. Co.,* 864 F.2d 557, 559-60 (7th Cir. 1988).

relitigate issues which should have been raised, if at all, on direct appeal. The Lanes have not demonstrated that they were precluded from raising these issues earlier.

In assessing sanctions, the District Court noted the lengthy prior proceedings, and found that since the appellate process had concluded, the motion was improper, and that Mundy's attempted action was improvident and contrary to the rules. We cannot say the District Court's findings are clearly erroneous, nor its conclusion that Rule 11 was violated, in error. See *Kurkowski v. Volcker,* 819 F.2d 201, 203 n. 8 (8th Cir. 1987). The Lanes do not challenge the amount of the sanction imposed.

Affirmed.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

APPENDIX B—ORDER OF DISTRICT COURT

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
TEXARKANA DIVISION

CLIFT C. LANE, et al

Plaintiffs,

vs.

JOHN E. PETERSON, JR., et al,

Defendants.

ORDER

NO. 86-4069

In this action the Court after several days of trial entered a Judgment July 2, 1987, dismissing the complaint filed by the plaintiffs, Clift C. Lane and Dorothy P. Lane, Individually and as Trustees under the above noted Trusts and in favor of the defendants. The Judgment on behalf of the defendants was entered pursuant to an extensive Memorandum Opinion entered by the Court following the lengthy trial and briefs filed by counsel for the parties.

The plaintiff were adequately and well represented by Howard Waldrop, Charles J. Hlavinka and Norman Russell of the well-known law firm of Atchley, Russell, Waldrop & Hlavinka of Texarkana, Texas. The defendant were represented by Ronald A. May, Isaac A. Scott, Jr., and Gregory T. Jones of the well-known law firm of Wright, Lindsey & Jennings of Little Rock, Arkansas.

The Judgment entered by the Court was appealed to the Eighth Circuit Court of Appeals. The appellate court affirmed the decision of this court and the motion for a rehearing by the appellate court was considered and denied on August 2, 1988.

This Court has now received a motion on behalf of the plaintiffs to vacate the Judgment entered by this court July 2, 1987. The motion at this late time of filing for the court to vacate the original judgment and enter judgment in favor of the plaintiffs was filed by the Honorable Raymond T. Mundy, Montebello Park, Suffern, N.Y. 10901. Although Mr. Mundy is an out-of-state attorney he represented himself as attorney for the plaintiffs without any indication of a relationship with the law firm representing the plaintiffs throughout the trial of the case and through the appeal processes. Not having had any indication of his interest as an attorney for the plaintiffs and no indication of his association with the previous law firm or any other law firm in the State of Arkansas, the motion to vacate the judgment of the court was improvidently entered.

On receiving the proposed motion filed by Mr. Mundy on behalf of the plaintiffs the court directed a letter to Mr. Mundy advising that his motion was filed by the clerk December 21, 1988, and a decision by the court in behalf of the defendants, that the case was appealed to the Eighth Circuit Court of Appeals and affirmed. Also, that a motion for a rehearing by the Court of Appeals, Eighth Circuit, was denied on August 2, 1988. He was also advised that there was no motion for a certiorari to the Supreme Court and the time for any additional action to be taken in the case had long since passed.

With the proposed motion to vacate Mr. Mundy, purporting to represent the plaintiffs, filed a request for permission to appear in behalf of the plaintiffs in the identified case.

In response to the proposed motion to vacate judgment counsel for the defendants opined that the defendants were being harassed. Further, that the case was thoroughly tried to the court and the plaintiffs were ably represented by counsel and the bench trial took place over five lengthy, consecutive days. The motion additionally was untimely and final consideration through processes had been determined in the case.

The Court having concluded that the motion was entered improvidently and the Court being well and sufficiently advised of the entire record, concludes that the motion to vacate is untimely and should be denied.

IT IS, THEREFORE, CONSIDERED, ORDERED AND ADJUDGED that the motion to vacate by an attorney that has not heretofore been noted in the record in any manner and that the motion being untimely and contrary to the rules of the court be and the same is hereby denied.

DATED this 18th day of January, 1989.

s/ Oren Harris
UNITED STATES SENIOR DISTRICT JUDGE

U.S. DISTRICT COURT
WESTERN DIST. ARKANSAS
FILED
JAN 18 1989

APPENDIX C—SUPPLEMENTAL ORDER OF DISTRICT COURT

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
TEXARKANA DIVISION

CLIFT C. LANE, Individually, ET UX.,
PLAINTIFFS,

VS. NO. 86-4069

JOHN E. PETERSON, JR., ET AL.,
DEFENDANTS.

SUPPLEMENTAL ORDER

This is a Supplemental Order to the Order entered by the Court January 18, 1989, denying the motion previously entered by a Mr. Raymond T. Mundy, Montebello Park, Suffern, NY 10901, representing himself as attorney for Clift C. Lane and Dorothy P. Lane in this above-identified action. The Court included in its previous Order dated January 18, 1989, the fact that Mr. Mundy had made no request to this Court to be permitted as an out-of-state attorney to appear in behalf of these plaintiffs. Other well known and highly qualified attorneys had represented the Lanes in a substantial trial to the Court.

The Court in its previous order referred to the fact that the motion purported to be filed by Mr. Mundy was improvidently entered in that he was not authorized to appear nor did he associate himself with a local attorney for such purposes.

As previously noted, this case was tried to the Court and concluded July 2, 1987. It was appealed to the Circuit

Court of Appeals, Eighth Circuit. The Court's judgment on behalf of the defendants was affirmed by the Circuit Court of Appeals, Eighth Circuit. The Eighth Circuit Court's opinion was filed June 30, 1988. Appellants petition for rehearing was denied August 2, 1988. In that the case had been litigated and appellate action concluded, it is obvious that this Court is without jurisdiction and such motion to vacate is obviously improper.

In response to the attempted filing by the Honorable Raymond T. Mundy, the Honorable Ronald A. May and Honorable Gregory T. Jones, of the law firm of Wright, Lindsey & Jennings, Little Rock, Arkansas, filed on February 1, 1989, a motion for sanctions. The motion relies on the several days of trial in the case, the appeal process concluding and decision for the defendants affirmed, and, therefore, claims that the motion is not only ill advised, but contrary to Rule 11 and 28 U.S.C. §1927 vioalted. It is the contention of counsel in the motion for sanctions that the action taken is for harassment, contrary to the rules and an attempt to relitigate the case all over again and virtually amounted to bad faith.

With motion for sanctions counsel files an itemized statement of disbursements, attorneys' fees and other costs in the sum of $3,262.79.

In the response to the motion for sanctions filed by defendants' counsel, the Honorable Robert T. Mundy, posing as attorney for the Plaintiffs, Lanes, has filed a response to the motion for sanctions, together with a brief in support thereof.

The Court can only conclude that the attempted action of counsel purporting to represent the Lanes is not

only an improvident act, but action contrary to the rules. Counsel purporting to represent the Lanes was obviously aware of the fact that this matter had been concluded months before his attempt to involve this Court further by passing judgment on a motion to vacate after the matter had been completely litigated and disposed of months before the filing of the motion. The Court is of the opinion that the motion for sanctions should be granted.

IT IS, THEREFORE, CONSIDERED AND ADJUDGED that the plaintiffs in this action and the Honorable Raymond T. Mundy purporting to appear as their attorney and each of them are hereby required to pay defendants' costs in responding to the motion, including defendants' attorney fees; that judgment herein be and is hereby entered jointly and severally against the Lanes and the Honorable Raymond T. Mundy, purporting to act for each of them, Lanes, in behalf of the defendants in the amount of Three Thousand Two-Hundred Sixty-One Dollars and Seventy-Nine Cents ($3,261.79), such amounts to be paid to defendants' attorneys, Wright, Lindsey & Jennings within ten (10) days from the entry hereof.

DATED this 3rd day of March, 1989.

s/ Oren Harris
UNITED STATES SENIOR DISTRICT JUDGE